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SUBJECT: MILITARY PENSION FUND WINS STEEL PRIVATIZATION  
TENDER

REF: Ankara 5352

This cable was coordinated with Congen Istanbul.

1. (SBU) Summary: On October 5, the Turkish Privatization Authority held a tender auction for another "Crown Jewel," the state-owned steel company, Erdemir (Eregli Iron and Steel Industries of Turkey). The OYAK group, the military pension fund with diversified industrial holdings, won the auction by bidding \$2.77bn for 46.12% of the company. The final figure was higher than expected. If this tender and those of Turk Telekom and Tupras are finalized, the privatization program will have taken a huge step forward. With the sale of Erdemir, the total value of privatizations in the past 12 months has reached approximately \$20bn, though most of the deals await final regulatory approval and the payments will be spread over several years. The fact that both Tupras and Erdemir were won by local groups will mean little increase in Foreign Direct Investment in the balance of payments. Moreover, the wins by dominant local groups without expertise in steel or oil refining suggests economic nationalism may have played a role. End Summary.

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Oyak Bids Aggressively and Wins the Tender Auction  
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2. (SBU) On October 5, in another tender auction broadcast live on television, the Privatization Authority (PA) sold 46.12 percent of Erdemir to the military pension fund (Oyak) for 2.77 billion USD. Together with the 3.17 percent share in Erdemir held by the Turkish Development Bank (TKB), which will be sold to the winner of the tender, the total bid amount went up to \$2.960 billion, valuing Erdemir at \$6.8 billion -- an 83% premium over its current market valuation.

3. (SBU) The high valuation continued a pattern: both the Turk Telekom and Tupras (oil refinery) tenders had achieved higher-than-expected prices. This reflects both current investor bullishness on Turkey, but also the PA's process which, once companies are pre-qualified (short-listed), drives up the price through open bidding, with price the sole criteria. The transparency and the high bids are helping the GOT deal with anti-privatization popular opinion. Although the critics try to argue that state assets are being sold too cheaply, the higher-than-market prices render this argument a hollow one. Nevertheless, the Black Sea community of Eregli, home of Erdemir's headquarters and most of its production, has been boiling with anti-privatization sentiment, including legal challenges from the local chamber of commerce and the labor union, as well as demonstrations. The CEO of Erdemir, a career company executive generally credited with restoring the company to profitability after he took over from a political appointee, resigned this summer out of opposition to the policy of selling a profitable state-owned company.

4. (SBU) Although 13 consortia purchased the privatization bid document for Erdemir, including U.S. Steel, only 6 groups actually competed on October 5. Big foreign steel companies like Luxembourg-based Arcelor and Indian-British Mittal; as well as Russian steelmaker Severstal, which had teamed up with a local consortium, bowed out during the auction when faced with aggressive bidding by Oyak and by a consortium of local companies led by TOBB (Union of Chambers and Commodity Exchanges of Turkey).

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Economic Nationalism Raises its Ugly Head  
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5. (SBU) More than the other recent privatizations, the possibility that Erdemir might fall into foreign hands had set off a wave of nationalist hand-wringing in recent months. The fact that a group of companies who buy Erdemir's steel combined under TOBB's leadership to act as a "national champion" was symptomatic. TOBB, which claims to be in favor of foreign investment and has been a key constituency in support of the economic reform program, revealed deep-seated nationalist reflexes, going along with

local businessmen's claims that a foreign owner might close Erdemir in a global downturn of the steel market, or fail to supply Turkish industry in a tight market.

16. (SBU) In the end, TOBB Chairman Rifat Hisarciklioglu, even though his group lost out to OYAK, gushed with nationalist pride that Erdemir had not fallen into foreign hands, publicly saying he was glad the Turkish flag would still fly over Erdemir. Hisarciklioglu's tone was also reflected in much of the press coverage of the tender. Oyak President Coskun Ulusoy, in his remarks that followed the auction, hinted that the Group was open to partnership in Erdemir. According to the tender document Oyak cannot lay off any workers in the next two years, and is required to invest a minimum of USD 2.5 billion in three years. Unlike most of the other bidders, Oyak Group has no experience in the steel sector except as a customer through OYAK-Renault, a joint venture in Turkey of the French car manufacturer Renault.

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Who is OYAK?  
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17. (SBU) International observers have long debated how to view OYAK. Is it the military's way of exerting influence in the economy or is it, as OYAK executives insist, a true pension fund that has invested in industrial assets because of the small size of Turkish financial markets? Huseyin Kelezoglu, an equity analyst at an Istanbul brokerage, told econoff he would not rule out that some of Oyak's motivation may have stemmed from the military's desire to keep Erdemir Turkish. Kelezoglu was careful, however, to say the GOT's only interest was to sell to the highest bidder. Opinion is divided on OYAK. The group's executives have business backgrounds and we understand the military leadership lets the businessmen run the company. Two of OYAK's executives, including the CEO, have strong U.S. connections: the CEO is married to an American and one of the Executive Vice Presidents used to be a business school professor in the U.S.

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Next Steps  
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18. (SBU) The PA will send the tender decision to the Competition Authority (CA) for its review. The Competition Authority (CA) will have three weeks to rule on the transaction's compliance with competition law. Once the transaction is cleared by the CA, it will move to the Supreme Privatization Council for its ruling. As with Turk Telekom, the Erdemir transaction includes a "golden share" to protect the continuity of the company. The PA will appoint a board member representing this share in Erdemir.

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Comment  
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19. (SBU) The Privatization Administration is on a roll: after years of failed privatizations there have been three highly-successful tenders of flagship companies which seem to be on their way to a successful conclusion. If these transactions are finalized, Turkey will have taken a major step away from its dirigiste, state-dominated past.

110. (SBU) On the other hand, the fact that two out of the three transactions were won by major local groups, will mean little new Foreign Direct Investment in the balance of payments, unless Koc expands Shell's role in Tupras and/or Oyak brings in an international steel group. The balance of payments is, however, likely to benefit from increased long-term borrowing from abroad to finance the acquisitions -- preferable to the current reliance on short-term portfolio investment to finance the current account deficit.

111. (SBU) The wins by Koc and OYAK also raise suspicions that economic nationalism, in one way or another, played too much of a role in the outcome. It seems unlikely that the PA rigged the bidding, but Oyak in particular may have bid too aggressively for reasons other than the profit motive. Huseyin Kelezoglu told econoff Koc only thinks in terms of business, but he went on to say Koc, as one of Turkey's largest groups, felt it had to get a piece of the privatization action, which is not the same thing as focusing on return-on-equity.

112. (SBU) American and most European corporations have long since abandoned the diversified conglomerate model, but it is alive and well in Turkey, personified by groups like Koc, Sabanci, Dogan and OYAK. The large number of joint ventures between these groups and foreign multinationals demonstrates that foreign groups need a local partner to run interference with non-transparent and anti-foreigner courts and regulators. This legacy of Turkey's closed-economy days is outmoded, but these private groups are still preferable to state control, so the privatizations are unquestionably a net plus.

